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THE ECONOMIC SIGNIFICANCE OF KHRUSHCHEV'S PLAN TO ABOLISH THE
PERSONAL INCOME TAX

OFFICE OF RESEARCH AND REPORTS

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CONFIDENTIAL**THE ECONOMIC SIGNIFICANCE OF KHRUSHCHEV'S PLAN TO ABOLISH THE
PERSONAL INCOME TAX**

In a speech to the Supreme Soviet on 5 May Premier Khrushchev outlined a plan for the gradual elimination of personal income taxes and the tax on bachelors during 1960-65. The intention to abolish such taxes was originally announced at the Twenty-First Party Congress and reiterated in connection with discussions of the Seven-Year Plan. The abolition of these taxes will undoubtedly prove highly popular and will raise the take-home pay of virtually all workers and employees, but will be of particular benefit to the middle-income groups. The major impact of the abolition, however, will not occur until the end of 1965. Since the taxes to be eliminated have provided only a small part of total budget revenue--which can readily be obtained from other sources--Khrushchev's plan will provide benefits to the population at minimum cost to the state. 1/

The Present System and Khrushchev's Plan for its Abolition

At present income taxes are levied on the wage and salary income of all workers and employees who earn more than 370 rubles per month. The basic rates range from 1.5 percent on an income of 371 rubles per month to approximately 12 percent on the highest incomes. Except for artists and writers, reduced rates are provided for persons with more than three dependents. A worker who is paid the currently estimated average monthly wage of 800 rubles and who has a wife and one or two children would pay an income tax of 7.2 percent. Much higher rates are levied on the private incomes of doctors, lawyers, and other professionals. In addition to the personal income tax, a "bachelor tax" of 6 percent of income must be paid by all single men.

Khrushchev's plan provides for the gradual elimination of personal income and bachelor taxes on workers and employees beginning on 1 October 1960 and to be completed on 1 October 1965. Taxes are to be abolished earliest for the lowest income groups, which also pay the smallest percentages of income tax. Thus, in 1962 the tax will be eliminated for all persons with monthly incomes of 700 rubles or less, and during 1963-64 the tax rate will be substantially reduced for persons earning between 700 and 1,000 rubles per month. As of 1 October 1965 the two kinds of taxes will be abolished for all workers and employees. As a result, persons with monthly incomes of 1,000 rubles or less will have an increase in take-home pay equal to the full amount of the taxes they paid. Persons with monthly incomes above 1,000 rubles will have wage or salary reductions which will partially or wholly offset the tax reductions. Persons with monthly incomes between 1,000 and 2,000 rubles will get increases in take-home pay ranging from 79 to 10 percent of the amount of the taxes they paid, and persons with monthly incomes over 2,000 rubles will get no increase in take-home pay. The bachelor tax will be eliminated for everyone and wages and salaries will not be reduced regardless of income. Khrushchev's statements about the effects of the successive cuts indicate that less than half the reduction in taxes in terms of revenue losses will occur before 1 October 1965. Thus the bulk of the economic effects will not occur until after 1965.

Collective farmers do not pay the personal income tax. The so-called "Agricultural Tax," a land tax which amounts to a tax on the income obtained by collective farmers from their private plots, is to be retained. Khrushchev's plan apparently applies only to workers and employees. Taxes on the incomes of all other taxpayers, probably not over 2 million, thus apparently would be retained, as also would taxes on the incomes of professionals obtained from private practice.

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Effects on State Revenues

Revenues from the income and bachelor taxes are a minor source of budget revenue. In 1958, the yield from these two taxes was 45.6 billion rubles, or 6.8 percent of total budget revenue. During 1959 and 1960, however, the tax on profits of state enterprises alone is planned to rise by 65 billion rubles. (see Table 1) In spite of the abolition of income taxes, budget revenue as a share of National Income will continue to rise as it has in the past, unless large additional reductions of other taxes are also instituted. Because of the scheduling of the reductions the decline in income tax revenue will be gradual, with the major impact coming in the last quarter of 1965.

Impact on the Soviet Worker

The abolition of the income and bachelor taxes will be of significant benefit to Soviet workers and employees. Khrushchev stated that when the tax abolition is completed, the take-home pay of 99.4 percent of workers and employees will be increased, and that the total increase in take-home pay will amount to 74 billion rubles in 1966. This amount represents 8.8 percent of the estimated total wage bill for workers and employees in that year. Thus, by the end of 1965, seven out of every eight Soviet workers will have their monthly take-home pay increased by amounts from 1.5 percent to about 12 percent. The only group not receiving some increase is the group of less than half a million persons earning more than 2,000 rubles per month.

The increase in average take-home pay resulting from the abolition of taxes will be in addition to the 26 percent increase in average money wages scheduled during the Seven-Year Plan period. In his speech, Premier Khrushchev explicitly recognized the need to provide additional consumer goods and services in order to absorb the increased purchasing power generated by the tax abolition. He talked vaguely about the allocation of additional resources to the consumer goods sector of the economy as a result of overfulfillment of production plans. Because the major impact of the tax abolition will not come until the latter part of 1965, however, most of the problem of providing consumer goods to match the increased purchasing power can be postponed to the next plan period.

The abolition of the taxes, in the absence of offsetting forces, will tend to narrow differentials in take-home pay between low and high paid workers, because workers with monthly incomes above 2,000 rubles will get no increase in take-home pay, and those with monthly incomes between 1,000 and 2,000 rubles will receive relatively small increases. Thus, the tax abolition will be of greatest benefit to workers earning between 700 and 1200 rubles per month. The intent and perhaps the effect of the abolition of income taxes, therefore, is consistent with the increases in the minimum wage and the wage and salary reforms also scheduled during the period of the Seven-Year Plan.

In his speech Khrushchev gave some figures which provide a rough estimate of the distribution of wage and salary income at the end of 1965. He stated (1) that after abolition of the taxes the cash wages of 59.4 million persons would increase by the entire amount of the previously paid tax; and (2) that 99.4 percent of workers and employees would have their take-home pay raised by all or part of the taxes previously paid. Assuming that there are 67 million workers and employees at the end of 1965, and assuming that the minimum wage is raised to 500 rubles as planned, the distribution of wages and salary incomes

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of workers and employees at the end of 1965 would be approximately as shown below. The estimated average (mean) monthly wage in 1965 is about 1,000 rubles.

| Monthly Income Bracket (rubles) | Number of Workers and Employees (millions) | Percent of Total |
|------------------------------------|--|------------------|
| 500-1,000 | 59.4 | 88 |
| 1,001-2,000 | 7.2 | 11 |
| Over 2,000 | 0.4 | 1 |

TABLE 1

REVENUE OF THE USSR STATE BUDGET

| | 1950 | | 1956 | | 1958 | | 1960 a/ | |
|----------------------------|-------------------|---------|-------------------|---------|-------------------|---------|-------------------|---------|
| | Billion Rubles | Percent | Billion Rubles | Percent | Billion Rubles | Percent | Billion Rubles | Percent |
| Turnover Tax | 236 | 56 | 259 | 44 | 304 | 45 | 317 | 41 |
| Profit Tax | 40 | 10 | 103 | 18 | 135 | 20 | 200 | 26 |
| Taxes on the Population | 36 | 8 | 50 | 9 | 52 | 8 | 57 | 7 |
| of which | | | | | | | | |
| Income Tax | 20 | -- | 37 | -- | 42 | -- | NA | -- |
| Bachelor Tax | 7 | -- | 9 | -- | 3 | -- | NA | -- |
| Agricultural Tax | 8 | -- | 4 | -- | 4 | -- | NA | -- |
| TOTAL | 423 | | 550 | | 672 | | 772 | |

a/ Plan

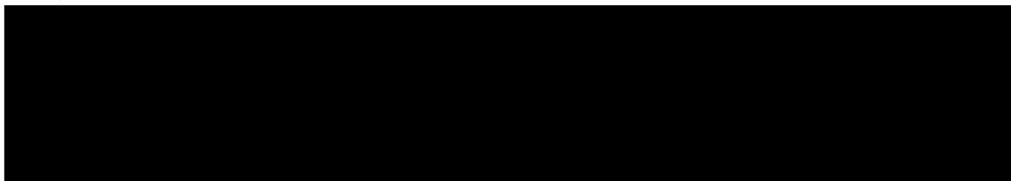
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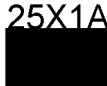


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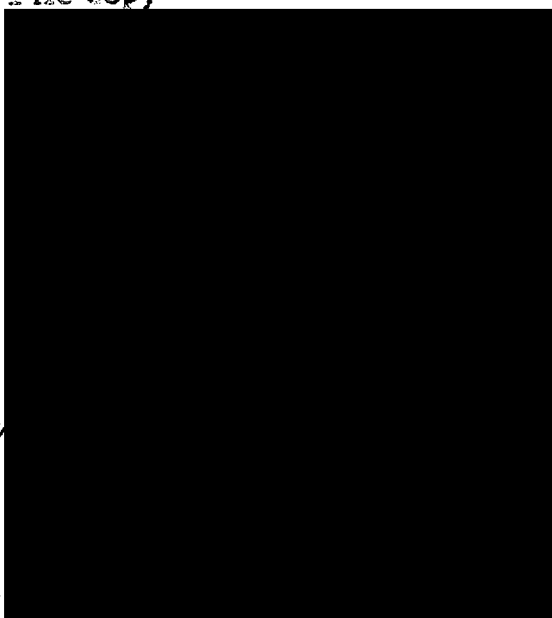
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